womblebonddickinson.com

Womble Bond Dickinson (US) LLP

1221 Main Street
Suite 1600
Columbia, SC 29201

t: 803.454.6504

Belton T. Zeigler
Partner
Direct Dial: 803-454-7720
Direct Fax: 803-381-9120
E-mail: Belton.Zeigler@wbd-us.com

October 30, 2019

VIA ELECTRONIC FILING

The Honorable Comer H. "Randy" Randall, Chairman
Public Service Commission of South Carolina
101 Executive Center Drive
Columbia, South Carolina 29210

Re: Procedure to Address Treatment of Deferrals (See Page No. 5 of Order No. 2019-341), Docket No. 2019-233-A; Responsive Comments

Dear Chairman Randall:

Dominion Energy South Carolina, Inc. ("DESC") files the following comments in response to the comments provided by the Office of Regulatory Staff ("ORS"), Nucor Steel Corporation ("Nucor") and Duke Energy Progress, LLC and Duke Energy Carolinas, LLC (collectively, "Duke") in this proceeding.

In its prior filing, DESC reviewed the rationale and policies behind deferral accounting orders and showed how over the years the Commission has used deferral accounting orders to benefit customers in many different contexts. Specifically, deferral accounting orders issued by this Commission have made it possible to delay rate proceedings, defer impacts from storms and encourage the accelerated implementation of discretionary programs or expenditures – like Advanced Metering Infrastructure ("AMI") – that benefit customers.

DESC generally agrees with the comments made by Duke in this proceeding and agrees, in part, with comments of ORS. DESC asks the Commission to consider carefully the value of the deferral accounting orders to customers and the regulatory process. DESC recommends that the

Commission safeguard the discretion it must have to use deferral accounting orders effectively for the benefit of customers going forward.

1. Response to Comments of ORS

In its comments, ORS asks the Commission to issue policy guidance defining a two-part analysis for the Commission to apply when it considers future deferral order requests. The proposed analysis is based on language from a North Carolina Utilities Commission order stating that the factors to consider are "(1) whether the costs in question are unusual or extraordinary in nature and (2) whether, absent deferral, the costs would have a material impact on the Company's financial condition."[1] ORS properly recognizes that consideration of these two factors has supported deferral accounting orders for "significant storm restoration and repair costs or construction of significant generating capacity." ORS Comments, p. 5.

DESC generally supports this formulation but with several important caveats.

i. Unusual or Extraordinary Costs

ORS properly points out that deferral accounting orders are not intended to deal with usual or ordinary utility expenses; therefore, the expenses subject to them should be unusual or extraordinary. ORS also suggests that, to qualify for deferral, expenses should also be "nonrecurring [sic] in nature and unexpected in the normal course of business operations." *Id.*

While the difference between these formulations may seem small, DESC would respectfully request that the Commission not include "non-recurring" or "unexpected" language in any order or policy statement issued here. Doing so may avoid future confusion or misinterpretation.

Specifically, hurricanes and ice storms are recurring events in South Carolina. One might also argue that they are to be expected in the course of utility operations. But, it is the Commission's clear policy, which ORS supports, that such storms are unusual or extraordinary, and that alone is sufficient to establish that they can be the subject of deferral accounting orders. Such deferral orders have been integral to storm damage reserve accounts that the Commission has authorized in past dockets and may wish to revisit in the future.

Similarly, in past decades, retrofitting coal generation plants with environmental upgrades was an expected part of maintaining generation system reliability. These retrofits occurred routinely across utility generation fleets. For that reason, it could be argued that these retrofits were both recurring and expected. Furthermore, individual expense items associated with major construction projects (*e.g.*, taxes, depreciation, operating and maintenance expenses) are recurring expenses when taken individually, even if the projects that they are associated with are not. Nevertheless, these projects are widely accepted as unusual or extraordinary and therefore qualifying for deferral accounting orders.

[1] *In the Matter of Application by Virginia Electric and Power Company, d/b/a Dominion North Carolina Power, for Approval of Amended Schedule NS*, Docket No. E-22, SUB 517, North Carolina Utilities Commission (March 29, 2016), 2016 WL 1295161.

Including "non-recurring" or "unexpected" language in the test for deferral accounting orders raises the potential for confusion and disagreement in future proceedings. DESC would respectfully submit that if a policy statement is to be adopted here, language requiring the expenses to be "unusual or extraordinary" is sufficient. There is no need to include additional language in any order or policy guidance issued in this proceeding.

ii. Materiality

The second prong of ORS's proposed analysis concerns "whether, absent deferral, the costs would have a material impact on the utility's financial condition." *Id.* While this may be a relevant consideration in some contexts, it may not be in others.

Deferral accounting orders may be based on a number of policy goals. Those goals may include the more appropriate matching of revenue and expenses to create generational equity; managing the timing of rate cases; or encouraging the accelerated implementation of discretionary programs or expenditures that benefit customers. Not all of these goals are concerned with the Company's overall financial condition nor are they all dependent on the amount of the expense rising to the level of a material concern in assessing financial health of the utility.

For example, the deferral orders related to AMI were granted to remove the financial penalty from the early implementation of AMI. Specifically, absent these orders, utilities would have had to absorb the additional depreciation, property taxes, implementation costs, carrying costs, and operating and maintenance expenses associated with AMI until a future rate case. Without a deferral order, it would have been in the utilities' financial interest to delay investing in programs like AMI until a rate case was imminent.

Accordingly, what motivated the AMI orders issued by the Commission was the value to customers of accelerated AMI implementation, not concerns about overall utility finances. The materiality of the cost of projects in light of the Company's overall financial health quite properly was not discussed in either of the requests for the deferral accounting orders or the orders themselves.[2]

The same is true of the accounting orders the Commission has previously issued related to economic development grants.[3] These grants benefit customers through encouraging economic

---

[2] *See, e.g.*, *In re Petition of Dominion Energy South Carolina, Incorporated for an Accounting Order Related to the Installation of Advanced Metering Infrastructure*, Accounting Order, Docket No. 2019-241-EG, Order No. 2019-622; *In re Petition of Duke Energy Carolinas, LLC for an Accounting Order to Defer Certain Costs Related to Advanced Metering Infrastructure (AMI)*, Accounting Order, Docket No. 2016-240-E, Order No. 2016-489; *In re Petition of Duke Energy Progress, LLC for an Accounting Order to Defer Certain Capital and Operating Expenses, Accounting Order*, Docket No. 2018-205-E, Order No. 2018-553.

[3] *See, e.g.*, *In re Petition of South Carolina Electric & Gas Company for an Accounting Order to Defer and Record as a Regulatory Asset Community/Economic Development Grants Made to Aiken County*, Accounting Order, Docket No. 2012-246-E, Order No. 2012-662 (related to Bridgestone Americas Tire Operations, LLC expansion, which created 850 new full-time and contractor positions in Aiken County); *In re Petition of South Carolina Electric & Gas Company for an Accounting Order (Barnwell County)*, Accounting Order, Docket No. 2009-497-E, Order No. 2009-

development, creating jobs and lowering utility costs due to a more efficient use of the utility system. Absent deferral accounting orders, these grants would have been expensed in the year made and no part of them would have been recoverable in future rate proceedings. The purpose of the deferral accounting orders issued for these grants was to encourage utilities to make them by removing, in part, the financial penalty the utility would otherwise suffer. Like the AMI deferral accounting orders, the benefit to customers from these deferral accounting orders did not depend on their overall effect on utility finances. That issue was not considered in the analysis leading to their approval.

In sum, financial materiality may be an important consideration in the review of certain deferral accounting orders. But, in instances where the benefits to customers from a deferral accounting order do not depend on the deferral's overall effect on utility finances, an exception should be recognized. In such cases, financial materiality should not be a controlling consideration in evaluating a request.

iii. Discretion in Granting Extraordinary Treatment for Deferral Accounting.

If the Commission decides to issue an order or policy statement in this proceeding, DESC would respectfully request that the evaluation of materiality should not be tied to any specific formula. Specifically, in its comments, ORS references "5% of utility income" as a potential standard based on the FERC Uniform System of Accounts, specifically 18 CFR Pt.101, General Instruction 7, Extraordinary Items ("General Instruction 7"). ORS Comments, p. 5. Including such a standard in an order or policy statement would not be sound regulatory policy and would not, in fact, be supported by General Instruction 7.

First of all, General Instruction 7 does not apply to deferral accounting orders. It defined the expense and income items that a utility would have had to treat as extraordinary items and separately state on its income statements for GAAP reporting purposes when doing so was required. But, this is no longer part of GAAP. *See* FASB Accounting Standards Update, No. 2015-01 at p. 1: "This Update eliminates from GAAP the concept of extraordinary items." It does not appear that General Instruction 7 has been updated in light of this change in GAAP accounting.

Furthermore, the use of the term "extraordinary" in the context of GAAP and General Instruction 7 had a very specific meaning related to how income and expenses were reported on an income statement. Circumstances giving rise to these special reporting requirements were intentionally rare. This accounting definition was intended to apply only to those very limited and specific cases.

Nevertheless, General Instruction 7 does not say that extraordinary expenses must exceed 5% of income to have been treated as extraordinary items on an income statement when doing so was possible. Instead, it says that extraordinary expenses representing 5% or more of income could have been considered material without FERC approval. Amounts under 5% could have been recognized as material upon review and approval by FERC. *See also Union Elec. Co., d/b/a AmerenUE, Plaintiff, v Pub. Serv. Comm'n of the State of Missouri*, 2002 WL 33947250 (Mo. Cir.

---

907 (economic development grant used to attract Crane Co. to relocate, consolidate, and merge with Dixie-Narco, Inc.).

May 17, 2002) (finding that utilities are not precluded from seeking, and the Commission is not precluded from granting, extraordinary treatment for items equal to less than 5% of net income). Therefore, the 5% standard was never intended to be a limit on regulatory discretion even in the limited circumstances where it applied.

As a policy matter, the 5% rule is a formulaic approach to measuring that can limit the Commission's discretion in cases where the practical benefits of the deferral accounting exists despite the rule not being met. This can be the case where (a) the utility's finances are such that a relatively small change in return could trigger a rate proceeding, or where (b) multiple deferral accounting orders of relatively modest individual amounts may be sufficient to delay the need for a rate filing. It can also be the case for items like AMI and economic development grants which are not tied to concerns with the overall financial health of the utility. DESC respectfully requests that the Commission not adopt a policy that limits its discretion in dealing with deferral accounting order requests in these circumstances.

iv. Estimated Expenses and Contingency Amounts

In its comments, ORS indicates that "deferral accounting treatment should not be granted for estimated expenses or contingency amounts." ORS Comments, p. 6. While this statement is generally accurate, some clarification may be in order. The amounts recorded under deferral accounting orders represent incurred costs by the utility. However, in order to ensure that costs are recorded in the appropriate period, accounting for incurred costs often requires the use of estimates until final costs are known. The use of estimates in this manner is a common application of accounting principles. This does not mean that the estimate is not an incurred cost but rather that the exact amount is not yet known. When the exact actual amount is known, estimates are adjusted or "trued up" to reflect those actual costs. The Company believes that the use of such estimates, as required by accounting standards, should be permitted in deferral accounting

In addition, a deferral accounting order ***request*** is generally made in advance of the expenditure and may cover a stream of costs or payments out in the future. Accordingly, requests for deferral accounting orders may be based on estimates of future costs which have not yet been incurred.

v. Carrying Costs

In its comments, ORS indicates that "[a] utility should not be allowed to accrue carrying costs on the deferred balance or accrue a return associated with capital expenditures because the carrying costs and deferred return are not an incurred cost of the utility." ORS Comments, p. 6. This is completely inaccurate. The deferral of a cost denotes that the utility has already incurred that cost, which has been funded through the issuance of debt or equity. The investors who provided that funding require payment from the utility in the form of interest or a return. These are real costs paid by the utility, no different from the payments made for the asset being deferred.

It is an axiom in ratemaking that utilities incur their cost of capital whenever they make capital expenditures benefiting their customers and systems. This concept is fundamental as is recognized in multiple past orders of this Commission and precedent from other jurisdictions. In fact, the constitutional law surrounding rate making is premised on the fact that the cost of capital is "an incurred cost of the utility" and failing to allow recovery of this cost is an unconstitutional taking of private property. *See, Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989) (noting that what is taken by a non-compensatory return "is not specific physical assets . . . but the capital prudently devoted to the public utility enterprise by the utilities' owners"); *see also*, *S. Bell Telephone & Telegraph Co. v. S.C. Pub. Serv. Comm'n*, 270 S.C. 590, 595–96, 244 S.E.2d 278, 281 (1978). This issue has also been addressed at length in the prior comments of DESC and Duke.

Furthermore, to categorically deny carrying costs erodes the usefulness of accounting orders as a means to delay rate proceedings or to encourage pro-customer investment between rate proceedings. To categorically deny carrying costs would limit the tools available to the Commission to manage the ratemaking process going forward.

vi. Actual Savings and Deferred Accounts

In its comments, ORS indicates that "the deferred account should also include any actual savings associated with the extraordinary or unusually incurred expenditure." ORS Comments, p. 6. This is logical. But, as a point of clarification, DESC understands that "actual savings" would not include savings that flow back to customers automatically through mechanisms such as the fuel clause or other regularly adjusted rate riders. In some cases, a significant portion of the savings from a capital investment made under a deferral accounting order (a highly fuel efficient combined cycle generation station, for example) would flow back to customers in this way. In addition, actual savings would only include savings that can be reasonably and objectively quantified during the accrual or amortization period.

vii. Utilities Must Be Able to Rely on Deferral Accounting Orders

In its comments, ORS indicates that "[a]pproval of an accounting order should be limited to approval for accounting purposes." ORS Comments, p.7. In this regard, ORS properly notes that the prudency of underlying expenses is not determined in issuing deferral accounting orders. However, it would seriously undermine the value of deferral accounting orders for customers and the regulatory process if utilities are not able to rely on these orders as establishing reasonable certainty as to the matters which they do address, specifically items such as the accrual of carrying costs, or the term of the amortization period. DESC respectfully requests that any order or policy statements made by the Commission in this proceeding affirmatively state that, absent compelling new circumstances or evidence, utilities may rely on the determinations as to accounting matters made in deferral accounting orders and these terms will be carried forward in rate proceedings.

viii. Accrual of Deferred Amounts

In its comments, ORS indicates that "[t]he time period for the deferred accounting treatment should be established in the accounting order . . . ." ORS Comments, p.7. It is not entirely clear what is meant here. But, apparently the intent is to establish an arbitrary cutoff for the period during which costs could accrue under a deferral accounting order. If so, the result could be a truncated deferral amount and pressure to file a rate proceeding at the end of the accrual period. In almost all cases, to function effectively, the accrual of the deferred amounts should continue until the utility's next rate proceeding. Allowing accrual on this basis has been the established practice before this Commission. To require a different rule would be to impair the usefulness of the orders and the Commission's discretion in issuing them.

The same is true of the suggestion that, in all cases, "a date should be established by which a utility should begin amortization . . . ." ORS Comments, p.7. This is another case in which the Commission should not issue a hard and fast rule but should maintain its flexibility to rule as circumstances require. In many cases, the appropriate date for amortization to begin is the effective date of the rates to be approved in the next utility rate order. Beginning amortization at a set time before that date can result in a truncated recovery of the deferred costs and pressure for the utility to file a rate proceeding. Whether amortization should begin on the effective date of the next rate order or at an earlier commencement date is a matter that should be evaluated on a case-by-case basis given the circumstances at the time.

ix. Amortization Period

In its comments, ORS indicates that "the amortization period for the deferred balance should be determined in the context of the next general rate case proceeding." ORS Comments, p.7. Presently, the Commission has discretion to set the amortization period when it issues the deferral accounting order. Maintaining the Commission's discretion on this matter would be good regulatory policy. There may be cases when establishing the amortization period in advance will be important and those matters should be judged on a case by case basis. There is no reason for the Commission to limit its discretion in these matters in advance.

x. Post-Amortization Revenue

In its comments, ORS indicates that "in the event the utility recovers deferred expenses for a period beyond the granted amortization period, the utility should record the additional revenue to the same deferral account such that it would be returned to customers." ORS Comments, p.7. This is as far as we can tell a rule applied in no jurisdiction, including South Carolina, and one that is contrary to sound ratemaking policy and practice.

When the Commission sets rates for a utility, those rates remain in place until the next rate case. For a major utility, thousands if not hundreds of thousands of items of expense and revenue move up and down between rate cases in ways that reinforce or offset each other. These changes continue until, cumulatively, they result in earnings that are depressed to a level where new rates are required.[4] In almost all cases, in the period between a rate proceeding, the utility is routinely under-earning its allowed return and is not in fact recovering the full measure of its cost of utility operations and capital. In such circumstances, to require the utility to give back to customers costs that it did not in fact recover or amounts that did not exceed its allowed return is both unjust and

[4] Theoretically, a utility might over earn its allowed return to a level that causes the Commission to order the Company in for a rate proceeding. In the real world, however, this almost never happens. Inflation, and increasingly stringent environmental regulatory and reliability standards mean that utilities are almost always under-earning their allowed returns.

unreasonable. As a practical matter, such a rule will limit utilities' ability to postpone rate cases, and will result in the filing of them more frequently.

xi. Reporting

In its comments, ORS requests regular reporting of information concerning outstanding deferred accounts. ORS Comments, p.8. DESC does not object to such reporting with two clarifications. First, DESC believes that annual reporting would be sufficient. While some deferral accounting orders have required quarterly reporting, it is not clear what actual value reporting at this frequency has provided. DESC respectfully requests that the Commission begin with annual reporting. If annual reporting were found to be insufficient, the Commission would retain the authority to increase the reporting frequency later. Second, DESC would clarify that any general reporting requirement should be for deferral accounts (*i.e.*, regulatory assets) that are not currently included in rates. The financial impacts of the regulatory assets that have been included in rates are reflected in the quarterly surveillance reports filed by the utilities and further reporting of them would have little use.

2. Response to Comments of Nucor Steel Corporation

Most of the substantive matters discussed in Nucor's comments overlap with those of ORS and do not require additional response. However, Nucor goes beyond ORS in suggesting that a deferral order should serve only as a "placeholder" in any future rate proceeding. Nucor Comments, p. 6. Specifically, Nucor argues that in a future rate proceeding the utility should be required to prove that the deferral order should have been issued in the first place. *Id.* at p. 6–7. Nucor would require the Commission to reopen "*all* issues related to the deferral," including issues related to carrying costs and amortization periods. *Id.* at p. 7.

While Nucor states that it "does not want to see the practice of accounting orders eliminated," adopting its proposed conditions could easily lead to that result. *Id.* at p. 3. Under accounting rules, a deferral accounting order is only effective to accomplish its intended purpose if a utility can reasonably rely upon it as providing assurance that future rate recovery of the amounts deferred is probable. If reliance is not warranted, the deferral accounting order has little value. But, Nucor ignores this requirement stating that "the Commission should affirm that the establishment of a regulatory asset does not create a presumption that the utility will be able to recover the regulatory asset at some point in the future." *Id.* at p. 6. Thus, Nucor would have the Commission include in its order, or policy statement, terms that could deny utilities the ability to use deferral accounting orders under established financial accounting guidance. By adopting Nucor's proposed conditions, the Commission would most likely eliminate a regulatory tool that it has used effectively for the benefit of customers in the past and, if preserved, can use for that purpose in the future.

3. Conclusion

For the reasons stated herein, DESC reaffirms the importance of the Commission preserving its flexibility in the use of deferral accounting orders as a regulatory tool for the benefit of customers going forward. Future customer benefits can be achieved if the Commission does so. DESC respectfully request the Commission not to issue any order or policy statement that limits its flexibility in issuing or structuring deferral accounting orders in ways that would damage the future utility of these orders for providing benefits to customers and managing the regulatory process.

Thank you for your consideration of these matters.

Respectfully submitted,

/s/Belton T. Zeigler

Belton T. Zeigler
Womble Bond Dickinson (US) LLP

Attorney for Dominion Energy South Carolina, Inc.